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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-1478

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS CORPORATION, duPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & CO., CHARLESTON INVESTMENT COMPANY, E.D. SYSTEMS CORPORATION, DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON and CHARLES W. COX, *Petitioners,*

v.

WINTHROP J. ALLEGAERT, as Trustee of duPont Walston Incorporated, *Respondent,*

- and -

NEW YORK STOCK EXCHANGE, INC., DOUGLAS E. DeTATA, JOHN J. DOUGHTY, ALLAN BLAIR and D. TIPP CULLEN, *Additional Respondents.*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

June 2, 1977

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REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

Pursuant to Rules 24(4) and 24(5), Petitioners[1] submit this Reply in support of their Petition for a

[1] Petitioners, all of whom are named defendants in this action, are H. Ross Perot, Electronic Data Systems Corporation, duPont Glore Forgan Incorporated, William K. Gayden, Morton H. Meyerson, Milledge A. Hart, III, Margot Perot, Mervin L. Stauffer, PHM & Co., Charleston Investment Company, E. D. Systems Corporation, Daniel J. Cullen, William D. Fleming, George T. Thomson and Charles W. Cox.

Writ of Certiorari to the United States Court of Appeals for the Second Circuit, docketed with the Court on April 25, 1977. The first section of this Reply will discuss the decision of the Fifth Circuit Court of Appeals in *Tullis* v. *Kohlmeyer & Co.*, 551 F.2d 632 (1977), which opinion was issued after the filing of the initial certiorari petition herein and which is squarely in conflict with the decision of the Second Circuit Court of Appeals in the instant case. The second section of this Reply addresses several of the Respondent's[2] contentions with respect to arbitrability of his securities laws claims which present matters not addressed in the initial Petition. The third section of this Reply addresses Respondent's contention that the court below—despite its own statement to the contrary—decided no issues of significance under the Bankruptcy Act.[3]

ARGUMENT

I. The Decision Below Directly Conflicts With a Decision of the Fifth Circuit Interpreting Section 28(b) of the Exchange Act.

Subsequent to the filing of the initial Petition, the United States Court of Appeals for the Fifth Circuit issued its decision in *Tullis* v. *Kohlmeyer & Co.*, 551 F.2d 632 (1977) (hereinafter "*Tullis*"). This decision is in direct conflict with the decision below, thus

[2] Respondent is Winthrop J. Allegaert, the trustee in bankruptcy of duPont Walston Incorporated (hereinafter "Allegaert" or "Respondent").

[3] Petitioners will not respond in this Reply to Allegaert's "Statement of the Facts," which merely summarizes the unproven allegations in his Complaint. Suffice it to say that they vigorously dispute all allegations of wrongdoing. In any event, such allegations are not relevant for purposes of determining Petitioners' right to arbitration under the United States Arbitration Act.

providing an important additional[4] reason for granting certiorari, and further illustrates the Second Circuit's misapplication of the governing statutory provisions and precedent in the instant case.

Tullis, like this case, involved the question of whether disputes arising under the Federal securities laws among members of the national securities exchanges may be arbitrated pursuant to the mandatory arbitration provisions of the exchange Constitutions. The Fifth Circuit held that such disputes are clearly arbi-

[4] As noted in the initial Petition herein, the decision of the court below also directly conflicts with the First Circuit's decision in *In Re Revenue Properties Litigation Cases* (*Cohn, Delaire & Kaufman*), 451 F.2d 310 (1971) (hereinafter "*Revenue Properties*"). See Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit (hereinafter "Pet."), pp. 16-18.

Allegaert argues that the decision below does not conflict with the First Circuit's decision in *Revenue Properties*, because *Revenue Properties* (a case which the Court of Appeals below ignored in its opinion even though it had been cited to the court by the Petitioners) reached the "same result" as a line of Second Circuit cases which the court below cited and attempted to distinguish. Allegaert ignores entirely, however, the First Circuit's clear, plain holding in *Revenue Properties* that the rule in *Wilko* v. *Swan*, 346 U.S. 427 (1953), simply does not apply when arbitration is sought pursuant to the arbitration provisions of an exchange constitution, because § 14 of the Securities Act of 1933, the statutory provision on which *Wilko* was based, by its terms does not apply in cases (such as in *Revenue Properties* and here) where the arbitration agreements were not entered into in connection with the acquisition of any security. *Revenue Properties, supra,* 451 F.2d at 313. Nor does it matter whether the claim under the Federal securities laws arises out of market transactions (as in *Revenue Properties*) or out of an investment in a brokerage house as Allegaert argues. *Tullis* involved a claim of securities fraud in connection with an investment in an exchange member firm. *See also,* Bankruptcy Judge Babitt's decision in *In the Matter of Blair* (Danford), No. 70 B 755 (S.D.N.Y. June 1, 1973) (App. F, pp. 97a-112a), which was cited in the court below by the Petitioners.

trable, without regard to the type of transaction out of which the claims arose. It based its holding squarely upon Section 28(b) of the Securities Exchange Act of 1934, 28 U.S.C. § 78bb(b). This decision is thus in direct conflict with the decision below which, for the first time, held that the provisions of the Constitutions of the national securities exchanges compelling arbitration of disputes among members (and among members and non-members at the insistence of the latter) could be enforced only with respect to "intramural transactions" or "mere internal brokerage industry squabble[s]," and would not be enforced when such disputes presented "institutional" fraud claims arising under the Federal securities laws. (App. A., pp. 11a-12a.)

Plaintiffs in *Tullis,* like Allegaert (the plaintiff here), had argued that arbitration of their securities law claims was barred under this Court's decision in *Wilko* v. *Swan,* 346 U.S. 427 (1953) (hereinafter "*Wilko*") and further argued that the exception to *Wilko* for exchange member disputes did not apply to their case, because it involved an investment by plaintiffs in Kohlmeyer & Co., a defunct brokerage firm in liquidation as of the time of the lawsuit.

Reviewing the long line of cases which had uniformly held that the exchange arbitration provisions are exempt from the non-waiver rule articulated in *Wilko,* the Fifth Circuit found that "the statutory and policy underpinnings" of these decisions were "sound" 551 F.2d at 638. The Fifth Circuit expressly endorsed the First Circuit's decision in *Revenue Properties.* 551 F.2d at 637. The Fifth Circuit noted that in *Wilko* this Court "had no occasion to consider the effect of § 28(b) on the non-waiver provisions." 551 F.2d at 636. When arbitration is sought against a member of

an exchange, "§ 28(b) is applicable and overrides the nonwaiver provisions which were the basis of *Wilko.*" *Id.* There is thus "little reason for the holding in *Wilko* v. *Swan* to be extended beyond cases involving ordinary investors to those between stock exchange members."[5] 551 F.2d 638.

Further, the court held, the type of transaction involved:

> "has no more relevance in determining whether arbitration is proper . . . than . . . in determining whether the substantative principles of the 1933 and 1934 Acts apply." 551 F.2d at 636.

Plaintiffs' membership in the exchange "took them beyond the realm of the ordinary investor" regardless of whether they were "outsiders" or "insiders" with respect to the transaction at issue.[6] 551 F.2d at 638. The "critical issue" is simply whether the party seek-

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[5] The Fifth Circuit also quoted Justice Stevens' dissent in *Alberto-Culver Co.* v. *Scherk,* 484 F.2d 611, 615-618 (7th Cir. 1973), *rev'd,* 417 U.S. 506 (1974), which noted that "in the two decades since the Supreme Court considered the collision between the two conflicting policies which made *Wilko* v. *Swan* such a close case," the policy of resolving disputes by arbitration had received "increasingly strong endorsement," citing, *inter alia, Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.,* 388 U.S. 395 (1967).

[6] Prior cases consistently have upheld exchange arbitration provisions even when the parties involved are no longer exchange members. See *Muh* v. *Newburger, Loeb & Co., Inc.,* 540 F.2d 970 (9th Cir. 1976) and *Isaacson* v. *Hayden Stone, Inc.,* 319 F.Supp. 929 (S.D.N.Y. 1970). In *Tullis,* the Fifth Circuit required arbitration even though Kohlmeyer & Co., the brokerage firm seeking to compel arbitration, was defunct. Also see *Nolde Bros., Inc.* v. *Local No. 358, Bakery & Confectionary Workers Union,* 45 U.S.L.W. 4251 (U.S. March 7, 1977). Thus, Allegaert's argument in opposition to the applicability of Section 28(b) based upon the fact that none of the Petitioners are now exchange members (Br., pp. 11-12)—an argument which the court below did not accept—is contrary to every decided case which has considered the issue.

ing to avoid arbitration has agreed to arbitration as a member of an exchange. *Id.* If this is the case, Section 28(b) applies. *Id.*

In reaching this result, the Fifth Circuit emphasized that the plaintiffs' proposed distinction (based on the type of transaction involved) "would be unworkable for practical reasons" and would result in "needlessly delaying and complicating litigation which typically already is difficult and burdensome." 551 F.2d at 636. It also stressed that, in recent years, "the scope of Rule 10b-5 and other securities provisions has grown to the point where a great number of disputes between exchange members may be stated in terms of the securities laws." 551 F.2d at 638. If arbitration "could be avoided at the will of any party claiming a securities law violation," the Congressional policy favoring exchange self-regulation "which is the basis of § 28(b) . . . would be weakened significantly." *Id.*

The decision of the Second Circuit in the instant case, however, needlessly complicates litigation and undermines exchange self-regulation in precisely the ways the Fifth Circuit's decision was intended to avoid. By limiting the overriding effect of Section 28 (b) of the Exchange Act in exchange member-member dispute situations based upon an attempted distinction between so-called "intramural" and non-intramural transactions, the court below adopted a "test" virtually identical to the "type of transaction" test the Fifth Circuit expressly rejected as contrary to statute, contrary to precedent and unworkable. Review by this Court thus is imperative to resolve a direct conflict between circuits, and to prevent application of a clearly erroneous standard of law in the circuit where most disputes between exchange members arise.

II. The Decision Below Conflicts With This Court's Decision in Prima Paint and With The Requirements of the Arbitration Act.

In the first section of his brief, Allegaert argues (i) that the decision below does not conflict with this Court's decision in *Prima Paint* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (hereinafter "*Prima Paint*") since it is "obviously irrelevant" and "simply has no bearing on this case" (Br., pp. 7 and 10), and (ii) that prior decisions of this Court which allegedly have found that arbitration of claims under Federal statute is "contrary to public policy and Congressional intent," provide adequate authority for the holding of the court below that arbitration may be denied based solely on the alleged "public interest" in a particular dispute and the alleged "uncertainty" of discovery. (App. A., pp. 9a-10a).[7]

It is true, as Allegaert notes, that *Prima Paint* involved "only common law claims." However, Alle-

[7] Allegaert also argues (Br., p. 10) that the Court of Appeals' application of its three-prong test of the "appropriateness" of arbitration based upon the facts in each particular case was merely *dictum* and that, with respect to Allegaert's securities law claims in particular, the court's decision was based solely on the rule in *Wilko* v. *Swan*. But the plain language of the decision below is to the contrary. (App. A., pp. 9a-10a.) The only mention of *Wilko* is in the paragraph following the discussion of the three-prong test, in which it is stated that "further support" for not permitting arbitration of Allegaert's securities law claims can be found in *Wilko* and one other case. (App. A., p. 10a.) The appellate court's choice of words thus negates the possibility that the discussion of *Wilko* was intended to be its only holding on the securities law issues, and instead suggests a clear intent to emphasize its three-prong test as the primary basis for its decision. As stated previously, *Wilko*, of course, does not in any way support the Court of Appeals' result, which is directly contrary to every prior case which has considered the applicability of *Wilko* to the exchange arbitration provisions.

gaert offers no explanation whatsoever as to why the clear holding of *Prima Paint*—that, under the Arbitration Act, the only issues to be considered are the "making and performance" of the agreement to arbitrate—applies with any less force where arbitration is sought with respect to claims under Federal statute. Nor does he offer any explanation—which the court below did not offer either—as to how the court's decision possibly can be squared with the unequivocal language of Sections 2 and 3 of the Arbitration Act, as interpreted in the *Prima Paint* decision. See Pet., pp. 11-13.

Moreover, contrary to Allegaert's assertions, this Court has never found any "public policy" against arbitration of statutory claims. Consistent with the Congressionally mandated Federal policy in favor of arbitration, established by the Arbitration Act, this Court has long expressed optimism with respect to the suitability of arbitration for resolving precisely such claims. See *Wilko, supra*, 346 U.S. at 431-432. Just two terms ago, in *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 519 (1974) the Court expressly rejected the "parochial concept" that only courts are capable of determining stock fraud questions under the securities laws, and arbitration has repeatedly been used or suggested as the appropriate forum for resolving disputes or claims arising under Federal statutes.[8]

Arbitration of Federal statutory claims under the Arbitration Act has been denied only under carefully

[8] See, for example, *United States for use of Capolino Sons, Inc.* v. *Electronic & Missile Facilities, Inc.*, 364 F.2d 705 (2d Cir. 1966); *Donahue* v. *Susquehanna Collieries Co.*, 138 F.2d 3 (3rd Cir. 1943); *Beckley* v. *Teyssier*, 332 F.2d 495 (9th Cir. 1964); *Evans* v. *Hudson Coal Co.*, 165 F.2d 970 (3d Cir. 1948); *Cavicchi* v. *Mohawk Manufacturing Co.*, 34 F.Supp. 852 (S.D.N.Y. 1940).

circumscribed circumstances, where denial of arbitration was *required* by a specific provision of law, which prevented arbitration of an *entire class* of claims. Thus, in *Wilko*, this Court refused to enforce a customer's agreement to arbitrate against his broker-dealer, only after finding that the customer's agreement (and *all* such agreements) to arbitrate was void under Section 14 of the Securities Act of 1933— a provision which does not apply to this case. (See Pet., pp. 16-18.)

Similarly, in *American Safety Equipment Corp.* v. *J. P. Maguire & Co.*, 391 F.2d 821, 826-827 (2d Cir. 1968), the seminal case on the arbitrability of antitrust claims, relied upon by all the decisions denying arbitration of antitrust and patent law claims identified by Allegaert in his brief (Br., p. 7 n. 3), the court denied arbitration only after it found that, if plaintiffs' allegations were correct, the agreement containing the arbitration clause itself would be an "instrument of illegality," void under the express prohibitions of the Sherman Act (See Pet., p. 15 n. 15).[9]

Alexander v. *Gardner-Denver Co.*, 415 U.S. 536 (1974) and *U.S. Bulk Carriers, Inc.* v. *Arguelles*, 400 U.S. 351 (1971), the only other decisions of this Court relied upon by Allegaert which involved arbitration of claims under Federal statute, arose under national labor relations statutes and do not involve the Arbitra-

[9] No similar finding is possible here, since two of the arbitration agreements sought to be enforced, the arbitration clauses of the NYSE and AMEX Constitutions, were entered into years before this dispute arose, in a wholly unrelated transaction. See Pet., p. 12 n. 11. *See, Tullis, supra*, 551 F.2d at 638, n. 8, and cases cited therein, further confirming the enforceability of these two agreements under the Arbitration Act.

tion Act in any way. Neither case was even cited by the court below.[10] Contrary to the implications of Allegaert's brief, however, even these cases, which are not remotely pertinent to the issues here, do not suggest any wholesale condemnation of arbitration as it applies to statutory claims. Instead, each case held only that an express right to a judicial hearing in a Federal district court guaranteed by a specific provision of Federal law was not barred by the labor arbitration agreements applicable therein.[11]

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[10] *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117 (1973) and *Bernhardt* v. *Polygraphic Co.*, 350 U.S. 198 (1956), the only other decisions of this Court cited by Allegaert, do not support the decision of the court below in any way. In *Bernhardt*, the only issue was whether Federal or state law governed an arbitration agreement which, unlike any of the three agreements involved in the instant case, did not satisfy the requirements of the Arbitration Act. And in *Ware*, the Court held only that a California statutory provision which governed the arbitrability of a contractual claim for wages was not pre-empted by NYSE Rule 347, which the Court characterized as a mere "housekeeping" rule. 414 U.S. at 136. By contrast, this case, which does not raise any question of pre-emption, involves the enforceability of the arbitration provisions of the exchange Constitutions, which have been called "the most significant of the measures taken to implement the [exchange] self-regulation contemplated by the 1934 Act." See *Cocnen* v. *R. W. Pressprich & Co.*, 453 F.2d 1209, 1215 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972), which the Court cited with approval in *Ware*, 414 U.S. at 135 n. 15, but which the decision below effectively overruled. The Court's holding in *Ware* also did not in any way conflict with the Arbitration Act since, if arbitration was barred under a specific provision of California law, then the arbitration agreement was invalid and unenforceable under § 2 of the Arbitration Act.

[11] Thus, in *Arguelles*, the only question was whether the "earlier, express, and alternative methods of collecting seamen's wages contained in 46 U.S.C. § 596 [i.e., an express grant of Federal district court jurisdiction over such claims] ha[d] been displaced by § 301 of the Labor Management Relations Act"—a question which a divided Court resolved in favor of allowing seamen optical

III. The Court of Appeals' Refusal to Permit Arbitration of the Trustee's Bankruptcy Act Claims Presents an Important Question of Federal Law Not Previously Considered by This Court.

Finally, Allegaert argues that the Court of Appeals never decided any important question of bankruptcy law, because it never reached what Allegaert apparently believes was an important issue in the case—*viz.*, whether the arbitration agreements at issue were executory contracts subject to rejection by Allegaert under Section 70b of the Bankruptcy Act.

Attempts to confuse the issues aside, the court below squarely held, for the first time in any decision that either side has unearthed, that a trustee in bankruptcy cannot be compelled to arbitrate claims which he initiates outside of the bankruptcy court under Sections 60, 67 and 70 of the Bankruptcy Act, even though no provision of the Bankruptcy Act releases the trustee from the bankrupt's inclusive arbitration agreements. It was this issue which the court below did decide and

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methods of recovery, after finding that nothing in § 301 suggested any intent by Congress to repeal the earlier and more specific statute, and also noting that federal courts had served a special protective role as guardians of seamen since the 18th century. 400 U.S. at 352 and 355-356. Similarly, in *Alexander* v. *Gardner-Denver*, the Court held only that arbitration of an employee's contractual rights under a collective bargaining agreement did not foreclose the employee's right to a trial *de novo* with respect to the special statutory rights available to him under Title VII of the Civil Rights Act of 1964. The Court expressly noted that: (i) the statute expressly provided the right to a trial *de novo*, as part of Congress' clear intent that Federal courts be assigned plenary powers to secure compliance with Title VII; (ii) that plaintiff's statutory rights were not within the scope of the arbitrator's authority, which by contract was limited to contractual issues; and (iii) that "legislative enactments in this area have long evinced a general intent to accord parallel or overlapping remedies against discrimination." 415 U.S. at 47.

which it was candid enough to acknowledge presented "significant questions regarding the interplay" of the two applicable Federal statutes—the Bankruptcy Act and the Arbitration Act. (App. A, p. 3a.)

Allegaert makes only a brief attempt to defend the appellate court's decision on this point by merely repeating the truism that a trustee in bankruptcy is allowed to avoid "defenses which would have been good against the bankrupt but not against its creditors." (Br., p. 14.) But the reason this statement is correct is that the Bankruptcy Act, by its own terms, relieves the trustee of certain otherwise valid defenses.[12] Neither the court below nor Allegaert, however, has made any showing that the obligation to submit to arbitration is a defense which may be avoided by the trustee within the terms of any such statutory provision.[13] The decision of the court below, contrary to every prior case, that a bankruptcy trustee suing alleged creditors of the estate in a plenary proceeding may *not* be compelled to arbitrate pursuant to the bankrupt's arbitration agreements, thus violates the fundamental principle of bankruptcy law that a trustee in bankruptcy is bound by the contractual obligations of the bankrupt unless released by statute, and should be reversed.[14]

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[12] For example, § 70 of the Bankruptcy Act expressly provides that the trustee may avoid any defenses which are fraudulent against creditors.

[13] Thus, to use the same example, no showing has been made as to how Petitioners' right to demand arbitration, arising out of Walston's decision to join the exchanges decades ago, can possibly be fraudulent against creditors under this provision.

[14] Allegaert also attempts to support the decision below by arguing that the contracts in which the arbitration clauses were contained were executory and therefore subject to his rejection. The Court of Appeals never reached this question. Had it done so there is little doubt it would have concluded, as did the District Court, that this argument rests on a "false assumption" because the contracts all had ceased to be executory well before the filing of the petition for bankruptcy, and thus no longer were subject to rejection under the Bankruptcy Act. (App. B, p. 23a.)

CONCLUSION

In his April 7, 1976 keynote address at the National Conference on the Causes of Popular Dissatisfaction with the Administration of Justice, Chief Justice Burger observed:

> "As the work of the courts increases, delays and costs will rise and the well-developed forms of arbitration should have wider use. Lawyers, judges and social scientists of other countries cannot understand our failure to make greater use of the arbitration process to settle disputes. I submit a reappraisal of the values of the arbitration process is in order, to determine whether, like the Administrative Procedures Act, arbitration can divert litigation to other channels."

In the Arbitration Act, the Congress of the United States reversed hundreds of years of hostility to arbitration in Anglo-American jurisprudence and gave Federal statutory sanction to agreements by which parties engaged in interstate commerce sought to avoid the "delays and costs" which the Chief Justice noted are on the rise in our congested courts. This case is a paradigm example of those delays and costs: notwithstanding three separate agreements between the parties selecting an arbitral forum for the resolution of *all* of their disputes, this case has been pending in the Federal courts for just short of two years; tens of thousands of dollars have been spent by each side on lawyers; and the dispute is not one inch closer to its ultimate resolu-

tion while the issue of its place of trial is fought over. The mandatory language of the Arbitration Act and the narrow judicial inquiry thereunder sanctioned by *Prima Paint* were designed to avoid this waste of court time, parties' time and money. But the court below has ignored that salutory purpose and its decision threatens to make the type of waste of time, effort and money which this case reflects the norm rather than the exception.

Respectfuly submitted,

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